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No. **437**

**In the Supreme Court of the United States**

**OCTOBER TERM, 1940**

**CARTER H. HARRISON, COLLECTOR OF INTERNAL  
REVENUE FOR THE FIRST DISTRICT OF ILLINOIS,  
PETITIONER**

**v.**

**SARAH H. SCHAFFNER**

**PETITION FOR A WRIT OF CERTIORARI TO THE UNITED  
STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH  
CIRCUIT**

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The Solicitor General, on behalf of Carter H. Harrison, Collector of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the Circuit Court of Appeals for the Seventh Circuit entered in the above-entitled cause on June 17, 1940.

## OPINIONS BELOW

The memorandum opinion of the District Court (R. 60) is not officially reported. The opinion of the Circuit Court of Appeals (R. 69) is reported in 113 F. (2d) 449.



**JURISDICTION**

The judgment of the Circuit Court of Appeals was entered on June 17, 1940 (R. 75). The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

**QUESTION PRESENTED**

A life beneficiary of a residuary trust, in November and December, assigned to her children and son-in-law specified amounts in dollars of the income that might be derived from the trust during the ensuing year. The question is whether the assignor, by executing such assignments, was thereby relieved of taxation upon the trust income during the ensuing year.

**STATUTE INVOLVED**

Revenue Act of 1928, c. 852, 45 Stat. 791:

**SEC. 22. GROSS INCOME.**

(a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on

for gain or profit, or gains or profits and income derived from any source whatever.

\* \* \* \* \*

#### SEC. 161. IMPOSITION OF TAX.

(a) *Application of tax.*—The taxes imposed by this title upon individuals shall apply to the income of estates or of any kind of property held in trust, \* \* \*

\* \* \* \* \*

#### SEC. 162. NET INCOME.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

\* \* \* \* \*

(b) There shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the beneficiaries, and the amount of the income collected by a guardian of an infant which is to be held or distributed as the court may direct, but the amount so allowed as a deduction shall be included in computing the net income of the beneficiaries whether distributed to them or not. \* \* \*

#### STATEMENT

The judgment of the District Court in this case was entered (R. 62) pursuant to the motion of the taxpayer (R. 59) for judgment on the pleadings. The pertinent facts, as established by the complaint



(R. 2) and answer (R. 53), may be summarized as follows:

In 1918 the taxpayer, Sara H. Schaffner, became entitled to the income for life of a residuary trust established by the will of her husband (R. 3, 18-24). On December 23, 1929, she irrevocably assigned in writing to her three children \$84,000 of the net income that might be derived from the trust during the year 1930. Of the net income thus assigned, \$36,000 was for one daughter; \$30,000 for another daughter; and \$18,000 for a son. (R. 3-4, 39-43, 54-55.)

On November 14, 1930, the taxpayer again executed irrevocable assignments of the net income of the residuary trust. These assignments, totalling \$54,000, covered income that might be derived from the trust during the year 1931 only. Her daughter, her son, and the husband of a deceased daughter each received \$18,000. (R. 4, 43-48, 55.)

The portions of the trust income thus assigned were paid by the trustee directly to the assignees (R. 4, 55).

The taxpayer filed income-tax returns for the years 1930 and 1931 (R. 3, 54) but did not include in either any portion of the trust income assigned by her (R. 4, 55-56).

The Commissioner of Internal Revenue held all of the assigned income to be taxable income to the taxpayer and, therefore, assessed against her the deficiency income taxes for the years 1930 and 1931.

These additional taxes were paid by the taxpayer. (R. 5-6, 56-57.)

The District Court entered judgment that the taxpayer was entitled to a refund of the deficiency taxes so paid (R. 62); the Circuit Court of Appeals affirmed the judgment. (R. 75).

#### SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that the income of the residuary trust which the taxpayer assigned should not have been included in her gross income.

2. In failing to hold that the income of the residuary trust which the taxpayer assigned was properly included in her gross income.

3. In affirming the judgment of the District Court.

#### REASONS FOR GRANTING THE WRIT

1. The decision of the Seventh Circuit in this case conflicts in principle with *Helvering v. Clifford*, 309 U. S. 331.

There, a husband, without reserving a power of revocation, declared himself trustee of certain securities to pay the income therefrom to his wife for five years. At termination, the corpus was to revert to him, while all accrued income was to go to his wife. He paid a gift tax upon the creation of the trust, and his wife reported in her separate returns all of the trust income distributed to her. This Court nevertheless held that the husband was taxable with respect to such income under Section

22 (a), notwithstanding that it had been distributed to another who was legally entitled to it. The Court regarded as the "basic issue" whether or not "the grantor after the trust has been established may still be treated, under this statutory scheme, as the owner of the corpus." P. 334. The considerations which brought about that result were summarized (p. 335) as being:

the short duration of the trust, the fact that the wife was the beneficiary, and the retention of control over the corpus \* \* \*

In answer to the argument that the control retained by the taxpayer was "the type of dominion exercised by any trustee," the Court stated (pp. 335-336) that "the answer is simple. We have at best a temporary reallocation of income within an intimate family group. \* \* \* For where the head of the household has income in excess of normal needs, it may well make but little difference to him (except income-tax-wise) where portions of that income are routed—so long as it stays in the family group."

In the case at bar, the taxpayer parted with merely a portion of the trust income for a twelve-month period only. She retained all other rights, including the rights to receive and control the disposition of the entire income in other years and to hold the trustee accountable for his administration of the corpus. The "short duration" of the trust, commented upon in the *Clifford* case, is more than

matched in this case. The recipients of her generosity were equally members of the family group.

The fact that the taxpayer was a life beneficiary under the trust and not the trustee, scarcely distinguishes this situation from the *Clifford* case. On the contrary, the fact that the taxpayer's original property here was an equitable life estate as opposed to ownership of the fee in the *Clifford* case, makes it clear that the "all-important factor" in this case is, not the power to manage the corpus, but rather the power to designate the recipients of the yearly income. The assignment was merely a substitute for an expenditure that the taxpayer would ordinarily have made out of her own income; she retained all the rights of dominion that, in the absence of an assignment, were important to her.

The decision of this Court in *Blair v. Commissioner*, 300 U. S. 5, is consistent with our position. There, the life beneficiary of a trust irrevocably assigned a substantial portion of *his entire equitable life estate*. Such circumstances afford basis for a holding that the assignor there did not retain enough of those perquisites of ownership which this Court in the *Clifford* case has held to be determinative of taxability. The situation here is materially different. Mrs. Schaffner's *equitable life estate* in the trust property was not assigned to anyone, in whole or in part; instead, she carved out of that estate a single year's income only.

In any event, we submit, the decision in *Blair v. Commissioner* should be no more controlling here than it was in the *Clifford* case.

2. The question raised in this case is cognate to the questions now before this Court in *Helvering v. Horst*, No. 27, 1940 Term, and *Helvering v. Eubank*, No. 205, 1940 Term. A decision favorable to the Government in those cases would probably require a reversal of the judgment in the case at hand. In the *Horst* case, especially, the situation resembles the one at bar. There, the taxpayer, who owned certain coupon bonds, detached negotiable interest coupons, prior to their maturity, and transferred them by manual delivery to his son as a gift. By so doing, it is true, the taxpayer gave up his right to the income for a short period of time. But in that case, as well as in the instant case, the taxpayer retained all his other rights, including his original right of control over the corpus and his right to receive and control the disposition of the entire income accruing during other years.

3. The decision of the Seventh Circuit, moreover, fails to apply the rules laid down by this Court in *Lucas v. Earl*, 281 U. S. 111, and in *Burnet v. Leininger*, 285 U. S. 136, governing the taxability of an assignor of future income.

#### CONCLUSION

It is therefore respectfully submitted that, for the foregoing reasons, this petition for a writ of certiorari should be granted.

FRANCIS BIDDLE,  
Solicitor General.

SEPTEMBER 1940.



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